No. 516

JAN 25 1951

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1950

---

ELWIN S. BENTLEY, E. MERRITT ASHWORTH, and LEROY P. BROWNELL, *Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE

---

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

---

HOWE P. COCHRAN,
510 American Building,
Washington 4, D. C.,
*Attorney for Petitioners.*

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

## INDEX.


| | Page |
|---|---|
| Opinions Below | 1 |
| Jurisdiction | 2 |
| Question Presented | 2 |
| Statutes and Regulations Involved | 2 |
| Statement | 2 |
| Specifications of Errors to Be Urged | 9 |
| Reasons for Granting the Writ | 9 |
| Conclusion | 13 |
| Appendix | 14 |


## CITATIONS.


CASES:

| | |
|---|---|
| *Commissioner of Internal Revenue* v. *Culbertson, et al.*, 337 U. S. 733, 69 S. Ct. 1210 | 9 |
| *Ginsberg, et al.* v. *Arnold*, CCA 5, 12/21/50 | 10 |
| *Henson* v. *Commissioner of Internal Revenue*, 174 F. (2d) 846 | 9 |
| *Lucas* v. *Earl*, 281 U. S. 111, 50 S. Ct. 241 | 12 |

STATUTES:

| | |
|---|---|
| Internal Revenue Code: | |
| Sec. 11 (26 U.S.C. 1946 ed., Sec. 11) | 14 |
| Sec. 22 (26 U.S.C. 1946 ed., Sec. 22) | 14 |
| Sec. 181 (26 U.S.C. 1946 ed., Sec. 181) | 14 |
| Sec. 182 (26 U.S.C. 1946 ed., Sec. 182) | 14 |
| Sec. 3797 (26 U.S.C. 1946 ed., Sec. 3797) | 14 |

MISCELLANEOUS:

| | |
|---|---|
| Treasury Regulations 111, Sec. 19.22(a)-1 | 15 |


190193

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1950

---

ELWIN S. BENTLEY, E. MERRITT ASHWORTH, and LEROY P. BROWNELL, *Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE

---

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

---

Elwin S. Bentley, E. Merritt Ashworth and LeRoy P. Brownell, all of Hoosick Falls, New York, pray that a writ of certiorari issue to review the judgment of the Court of Appeals for the Second Circuit, decided October 31, 1950, affirming a decision of The Tax Court of the United States, found in 14 T. C. 228.

## OPINIONS BELOW

The opinion of The Tax Court of the United States is reported in 14 T. C. 228 (R. 192). The opinion of the Court of Appeals is reported in 184 F. (2d) 668 (R. 220).

## JURISDICTION

The judgment of the Court of Appeals was entered on October 31, 1950 (R. 220). The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

## QUESTION PRESENTED

The question presented is as follows:

> Should the petitioners be taxed on the income of a partnership in which they were not partners, in which they had no beneficial or proprietary interest, none of the income of which belonged to or ever reached them?

## STATUTES AND REGULATIONS INVOLVED

These are set forth in the Appendix, pp. 14-15.

## STATEMENT

The controlling facts in this case are as follows:

Mrs. Marion Brownell, Mrs. Helen Ashworth and Mrs. Ethel Bentley (hereinafter sometimes called the women) formed a partnership on the 28th of November, 1944, for the purpose of manufacturing plastic automobile parts (R. 122; Tax Court Findings of Fact—R. 193). Mrs. Brownell, Mrs. Ashworth and Mrs. Bentley put up the entire cash capital of the business, which was $4,580, from their own funds, earned and saved by them from their own personal efforts (R. 43; 89; 108; 119-120; 143; Tax Court Findings of Fact—R. 197). Mrs. Brownell, Mrs. Ashworth and Mrs. Bentley started in business under the name of Hoosick Engineering Company, a partnership, and filed the proper notices thereof with the State of New York and the counties in which they meant to operate (R. 129-131; Exs. 23 and 24; Tax Court Findings of Fact—R. 198). They also filed notice of their intentions with the Commissioner of Internal Revenue (Tax Court Findings of Fact—R. 198). Mrs. Brownell, Mrs. Ashworth and Mrs. Bentley went into

this venture in good faith, meaning to be partners (R. 121-122; R. 142-143). Mrs. Brownell, Mrs. Ashworth and Mrs. Bentley pledged their personal credit in this business. They purchased the accounts and the inventories of a liquidating corporation for $36,764.08 (Tax Court Findings of Fact —R. 196-197), and took title to them on November 30, 1944, the day they went into business (Ex. 13; Tax Court Findings of Fact—R. 196-197). On that day they took over the business of the liquidating corporation (Tax Court Findings of Fact—R. 196-197). They paid the $36,764.08 over a period of 14 months (R. 92; Tax Court Findings of Fact—R. 198). They rented, from the ex-stockholders, the machinery of the liquidating corporation, which had a value of ($11,339.02—R. 85; 94) something less than one-third of the value of the inventories and accounts, for a rental of approximately 15% of its value, and they paid the rent ($1,713.10—R. 85) promptly (R. 68; 85; 94). They rented the manufacturing building used by the old corporation from its owner, as the old corporation had done, and paid the rent on that building promptly (R. 95). They rented the use of the name of the defunct corporation at $1.00 a year; the good will of the defunct corporation at $1.00 a year; and took over a month-by-month unwritten "lease" of the building at $1.00 a year (R. 51-52; 95; Ex. 10). The trade name, the good will and the leasehold of the liquidating corporation had no value (R. 95; 116-117). Mrs. Brownell, Mrs. Ashworth and Mrs. Bentley maintained absolute control of the bank accounts of the partnership's business (R. 45; 120-121; 141). All checks had to be signed by two of them (R. 45; 121; Tax Court Findings of Fact —R. 199: "two of the wives were required to sign them."). No one could draw any of the partnership's money, or take any of the partnership's profits except themselves (R. 45; 121; Tax Court Findings of Fact—R. 199). The partnership made money in 1945 and 1946, and Mrs. Brownell, Mrs. Ashworth and Mrs. Bentley drew all the profits

and kept or spent them according to their own desires (R. 120; 122-123; 143; Tax Court Findings of Fact—R. 198).

None of the profits ever went to the husbands (Tax Court Findings of Fact—R. 198).

To facilitate the operation of the business, Mrs. Brownell, Mrs. Ashworth and Mrs. Bentley employed a bookkeeper named McGuire (R. 75), a manufacturer and factory superintendent named Benway (R. 71), and their husbands, Mr. Brownell, Mr. Ashworth and Mr. Bentley, as part-time managers (R. 121; Tax Court Findings of Fact—R. 200). They employed counsel to go over their accounts and to advise them (R. 43; 121; 141). They employed 17 to 20 workers (R. 102; Tax Court Findings of Fact—R. 201). They paid Mr. Brownell, Mr. Ashworth and Mr. Bentley the same salaries, at first, that the defunct corporation had been paying them (R. 52; Ex. 10; Tax Court Findings of Fact—R. 197), but in a later year made an adjustment with their husbands, giving them an incentive bonus out of the profits before computing the partnership's profits (R. 132; Tax Court Findings of Fact—R. 199).

Background facts which are deemed to be important are as follows:

Mrs. Brownell, one of the women, Mr. Brownell, Mr. Ashworth and Mr. Bentley for a number of years had owned the stock of a corporation called the Lovejoy Patent Specialty Company, Inc. (sometimes hereafter called Lovejoy) (R. 47; 56-57; Tax Court Findings of Fact—R. 200). Lovejoy manufactured chaplets and inserts (R. 47). Mrs. Brownell owned 100 shares, Mr. Bentley owned 105 shares, Mr. Brownell owned 262 shares, and Mr. Ashworth owned 362 shares (R. 81). Mr. Bentley had come into the concern about 1920 as the result of a merger, and a controversy had arisen between him and Mr. Brownell and Mr. Ashworth about his compensation (R. 80). This controversy raged unabated for many years and continued up until the events here under consideration took place (R. 80; 149).

In 1939 a New York corporation, the Hoosick Engineering Company, a customer of Lovejoy, a manufacturer of dis-

tributor heads and rotors for automobiles, got into financial trouble and the owners of Lovejoy, seeking to avoid the loss of an outlet, bought it for $17,000 (R. 47; 57-59; 115; Tax Court Findings of Fact—R. 193). They then put up $420.00 as working capital and incorporated the business as Hoosick Engineering Company, Inc. (R. 54; 59; Ex. 12; Tax Court Findings of Fact—R. 193). The stock in the Hoosick Engineering Company, Inc., like the stock in Lovejoy was owned by Mrs. Brownell, 100 shares, Mr. Bentley, 105, Mr. Brownell, 262, and Mr. Ashworth, 362 (R. 81; Tax Court Findings of Fact—R. 194). The Hoosick corporation lost money the first year, 1939, made money in 1940, 1941, 1942 and 1943; but, in 1944, when times were good and everybody was making money, its sales fell off 25% and it showed a net operating loss (R. 91; Tax Court Findings of Fact—R. 194-195). In the year 1944, an excess profits tax assessment for 1943 ($31,104.52) and an extra tax bill for prior years ($4,994.23) fell upon the Hoosick Engineering Company, Inc. (R. 91; Tax Court Findings of Fact—R. 195). These demands reduced its net surplus, which had been accumulated over five years of operations without paying any dividends, to approximately $21,000 (Ex. 12). Due to this excessive tax burden, to discouragement over the prospects of the business, to fears for the future, and to the continuous quarrels between the three men, it was decided to sell or liquidate both Lovejoy and Hoosick (R. 91-92; 109; 148-149; Tax Court Findings of Fact—R. 196). Attempts were made to sell both businesses. The attempts were unsuccessful (R. 117; Tax Court Findings of Fact—R. 196). At this juncture, H. P. Cochran, a Washington, D. C., lawyer, who had had the Hoosick account since the corporation was organized, and who specialized in Federal tax work and in business management, and who had among his clients numerous persons who bought and sold businesses, was contacted (R. 147-148; 151-152; Tax Court Findings of Fact—R. 196). He was asked to sell the two businesses (R. 152).

Mr. Cochran did not share the discouragement of Mr. Brownell, Mr. Ashworth and Mr. Bentley, and thought the

prospects for both businesses were good (R. 148-149). He was unable to sell the Hoosick business because it made a product out of plastics (R. 152); but he did sell the Lovejoy company to his own daughter, a Washington, D. C., lawyer, Mrs. Betty Stockvis (R. 89; 134; 152; Tax Court Findings of Fact—R. 200). Mrs. Stockvis, as a condition of the purchase, made a contract with Messrs. Brownell, Ashworth and Bentley whereby they agreed to stay on and run the business for her until each of them was 65 years of age (R. 152; Tax Court Findings of Fact—R. 200).

No buyer having been found for Hoosick, it was decided to liquidate that corporation (R. 148-149). The liquidation was set for November 3, 1944, and Mr. Cochran employed New York counsel to help with the liquidation (R. 148-149). Both counsel believed the liquidation to be a mistake, and did not liquidate the company on November 3 as they had been instructed to do (R. 149). They wanted to avoid the losses on inventories and accounts incident to such a liquidation (R. 48). A controversy ensued and it was agreed to liquidate the company on November 28, 1944, and this was effectively done (R. 150; Tax Court Findings of Fact—R. 196).

On November 24, 1944, Mr. Cochran and Miss Margaret F. Luers, a member of the Bar of the District of Columbia and Mr. Cochran's office manager and chief associate in the practice of law, went up to Hoosick Falls, New York, for the purpose of making the final arrangements for the liquidation (R. 150-151). Mr. Cochran had undertaken to sell the business to Miss Luers, who was a woman of property, but she would not buy it (R. 150). On the way up to Hoosick Falls, on November 24, 1944, Miss Luers suggested to Mr. Cochran that, upon the liquidation, Mrs. Brownell, Mrs. Ashworth and Mrs. Bentley might buy and operate the business (R. 150-151). All of these women had been in business and had earned and saved money. Mrs. Brownell was already a 12+% owner of the Hoosick business (Tax Court Findings of Fact—R. 194). Mr. Cochran

had not considered such a sale, and November 24, 1944, is the first time it was mentioned (R. 109; 121; 144; 150).

When Mr. Cochran and Miss Luers reached Hoosick Falls, Mr. Cochran went ahead with the plans for liquidation. Miss Luers, after first asking Mr. Ashworth's consent, undertook to contact Mrs. Ashworth, but failed to reach her (R. 150). Miss Luers then contacted Mrs. Bentley. Mrs. Bentley proved to be interested in the matter (R. 143; 150-151). After lunch, Miss Luers successfully contacted Mrs. Ashworth, who proved to be interested in the matter also (R. 135-137; 151). It was agreed that these two women, Mrs. Bentley and Mrs. Ashworth, should contact Mrs. Brownell, discuss whether they would be interested, and notify Mr. Cochran of their decision (R. 151). Miss Luers went to see Mrs. Bentley and Mrs. Ashworth on her own initiative, and not at the behest of Mr. Bentley or Mr. Ashworth (R. 121; 137; 150). Mr. Bentley had not heard of the matter until he learned of it from his wife—after Miss Luers had spoken to her (R. 143; 145).

Mr. Cochran and Miss Luers returned to New York on the evening of November 24, and Mrs. Ashworth telephoned Mr. Cochran, and also wrote him, that the three women, Mrs. Brownell, Mrs. Ashworth and Mrs. Bentley, would buy the business (R. 151). As a consequence, after the Hoosick corporation was liquidated on November 28, 1944, and its assets distributed to the stockholders, of whom Mrs. Brownell was one (Tax Court Findings of Fact—R. 196), Mrs. Ashworth, Mrs. Brownell and Mrs. Bentley took over the business (R. 92; Tax Court Findings of Fact—R. 196-197). They bought and took title to (Tax Court Findings of Fact—R. 196-197), and paid for (Tax Court Findings of Fact—R. 198) the accounts and the inventories, rented the machinery (Tax Court Findings of Fact—R. 196), and undertook to manufacture plastic automobile parts and to sell them (R. 92; Tax Court Findings of Fact—R. 197).

The business under the ownership of Mrs. Brownell, Mrs. Ashworth and Mrs. Bentley, with their absolute control of the money (Tax Court Findings of Fact—R. 199:

two of the women were required to sign checks), prospered, whereas it was languishing and losing money at the time the corporation was liquidated (Tax Court Findings of Fact—R. 194-195).

Some months after November 28, 1944, a further controversy arose between the men, as a result of which the salary of Mr. Brownell and Mr. Ashworth was increased by about $5,000 each, and the salary of Mr. Bentley was not increased (R. 131; Tax Court Findings of Fact—R. 199).

It was not part of Miss Luers' suggestion that Mr. Brownell, Mr. Ashworth and Mr. Bentley would be employed by the women (R. 138; 151). This idea came as an afterthought, because the men were available and competent (R. 136; 138; 151).

Mrs. Brownell, Mrs. Ashworth and Mrs. Bentley could have employed other men to run the business in place of their husbands, had they desired to do so (R. 103). The men could have quit at any time, and they could have been discharged at any time (Tax Court Findings of Fact—R. 203).

The plan was not a tax-saving, tax avoidance or tax-reducing scheme. The corporation was currently losing both sales and profits (Tax Court Findings of Fact—R. 194). It owed no taxes; they were paid (Tax Court Findings of Fact—R. 195). The corporation was being liquidated and was never going to do any business or make any money, and it was never going to owe any further taxes (Tax Court Findings of Fact—R. 196).

The undertaking of the women was a business gamble when they went into it, and they knew it was a gamble (R. 135-137; 145; 151). The men were not willing to take this gamble and were unwilling to be in a partnership (R. 63; 91; 98-99; 118; 149). They were sick of the responsibility and wanted to be done with it (R. 62; 63; 118; 119).

The partnership participation interests between the women were 200/458, 200/458 and 58/458 (Tax Court Findings of Fact—R. 197). These proportions are different

from the proportions that the husbands had in the defunct corporation (362/829, 262/829 and 105/829) (Tax Court Findings of Fact—R. 194), but are approximately the same as those Mrs. Brownell and the men combined had in the defunct corporation.

## SPECIFICATIONS OF ERRORS TO BE URGED

The Court of Appeals erred:

(1) In holding, contrary to the provisions of the Internal Revenue Code, and contrary to the decision of the Fifth Circuit in *Henson* v. *Commissioner of Internal Revenue,* 174 F. (2d) 846, that the income of a business financed and owned by three women, which income belonged to the women, and was drawn down by the women, is taxable to their husbands.

(2) In holding, contrary to the decision of this Court in *Commissioner of Internal Revenue* v. *Culbertson, et al.,* 337 U. S. 733, 69 S. Ct. 1210, that partnership income is taxable to the husbands of the partners and not to the "* * * partners [who have] joined together in good faith to conduct a business, having agreed that the services or capital to be contributed presently by each is of such value to the partnership that the contributor should participate in the distribution of profits * * *."

(3) In failing to tax partnership income to partners as provided by the Internal Revenue Code, and in taxing partnership income to non-partners simply because the partners were married women.

(4) In failing to decide this case according to the true facts as shown by the record.

(5) In failing to reverse the Tax Court.

## REASONS FOR GRANTING THE WRIT

(1) There is a conflict between the decision in this case and the decision of the Fifth Circuit in *Henson* v. *Commissioner of Internal Revenue,* 174 F. (2d) 846.

(2) There is a conflict between the decision in this case and the decision of this honorable Court in *Commissioner of Internal Revenue* v. *Culbertson, et al.*, 337 U. S. 733, 69 S. Ct. 1210.

There is also a conflict between the decision in this case and the case of *Nathan Ginsberg* and wife, *Mollie Ginsberg* v. *Arnold*, decided December 21, 1950, in the Fifth Circuit, following *Commissioner of Internal Revenue* v. *Culbertson, et al.*

(3) This case has been decided contrary to the provisions of the Internal Revenue Code.

(4) This case has been decided contrary to the facts of record.

(5) Justice has not been done.

These items will be taken up in order:

(1) There is a conflict betweeen the decision in this case and the decision of the Fifth Circuit in *Henson* v. *Commissioner of Internal Revenue*, 174 F. (2d) 846.

The Fifth Circuit has held in the *Henson* case that even when a man donates a business to his wife and then stays and runs it for her, the income is nevertheless hers. The case at bar holds that where three women form a partnership and buy a business with their own money, earned and saved by them, control it absolutely by exclusive control of the money, and keep all the profits, the income is taxable to their husbands who have no beneficial interest in the business, if the husbands work for them. The only difference between this case and the *Henson* case is that, in the *Henson* case, the interest of the wife was received by her as a gift from her husband, and in this case the interests of the wives were bought by them with their own money. This case is therefore stronger than the *Henson* case. Moreover, in the *Henson* case the husband controlled the finances of the business, whereas in this case the wives maintained ab-

solute control of the money. For that reason, too, this case is stronger than the *Henson* case.

(2) There is a conflict between the decision in this case and the decision of this honorable Court in the *Culbertson* case.

In the *Culbertson* case this honorable Court held that the intention by the partners to carry on a partnership in good faith, and the control and ownership of the profits, as well as the contribution to the capital, were determining factors of a partnership interest.

In this case we have all of those features contributed by Mrs. Brownell, Mrs. Ashworth and Mrs. Bentley. These three women went into the partnership in good faith with the hope of making money. They financed the business from their own funds. They controlled the money and they drew the profits. Their husbands, the petitioners here, had no proprietary interests, assumed no business risks, owned nothing and got nothing. Yet the Tax Court has substituted its will for the will of the parties, has ousted Mrs. Brownell, Mrs. Ashworth and Mrs. Bentley from their own partnership, and has forced Mr. Brownell, Mr. Ashworth and Mr. Bentley into a partnership in which they own nothing and can get nothing, a partnership that they would not think of going into of their own accord, and that they did not go into.

It is respectfully suggested that the partnership as formed by the parties should stand; and the one formed by the Tax Court should be set aside.

It will be noted that the case at bar reflects an alarming tendency on the part of the taxing authorities, the Tax Court and the United States Court of Appeals for the Second Circuit, to discriminate against married women in business, and an alarming tendency on the part of the taxing authorities and the Tax Court to set up a paternalistic taxing system, contrary to the Constitution of the United States, the Internal Revenue Code, and the Regulations of

the Commissioner of Internal Revenue, under which all the income of all the working members of the family is charged against and taxed to the male head of the family group even though he cannot reach it, and never could. This case is the final step on the part of the Commissioner in assessing income taxes on a family basis.

This case also demonstrates the alarming tendency of the Tax Court, in cases where wives employ their husbands instead of strange men, to extend to absurd lengths the rule of *Lucas* v. *Earl,* 281 U. S. 111, 50 S. Ct. 241 (and the many cases that followed) that income is taxed to the one who earns it.

Here three women own, finance and operate a business which manufactures a quantity-production product. The income is theirs, and they take it. The factory has a superintendent and about 20 workers.

But, since these women employed their husbands as part-time managers, the Tax Court attributed all the profits to the husbands, and taxed the husbands, although they could never touch a dime of those profits.

It is respectfully suggested that the rule that income is taxed to the one who earns it does not mean that the workers in a factory, or the managers thereof, are to be taxed on the factory's income, and that the owner may go tax free.

The recent case of *Ginsberg, et al.* v. *Arnold* in the Fifth Circuit, following the *Culbertson* case, is in sharp conflict with the case at bar. In that case the ownership and control of the partnership profits by three children who had acquired their share of the partnership capital from their parents was given great weight and the partnership was upheld. The case at bar is much stronger than the *Ginsberg* case, first, because the women in the case at bar owned the entire partnership; and second, because they provided their own capital, and kept all the profits.

(3) This case has been decided contrary to the provisions of the Internal Revenue Code.

The Internal Revenue Code expressly provides that there shall be no income tax upon partnerships as such, but that the income tax on the income of a partnership shall fall upon the partners according to their distributive shares. This case holds that if the partners be married women, the income tax shall fall upon their husbands in proportion to the distributive shares of their wives; and that their wives shall be allowed to own and operate the partnership and take the profits tax free.

It is respectfully suggested that this holding is contrary to the Internal Revenue Code and the rule of reason.

(4) This case has been decided contrary to the facts of record, and

(5) Justice has not been done.

The finding of the Tax Court that the partnership of Mrs. Brownell, Mrs. Ashworth, and Mrs. Bentley was not a bona fide one is not true, and is not supported by the evidence.

The ultimate fact found by the Tax Court is contrary to the other facts found by the Tax Court and is not supported by the evidence.

## CONCLUSION

It is respectfully prayed that the writ of certiorari be granted.

Respectfully submitted,

HOWE P. COCHRAN,
510 American Building,
Washington 4, D. C.,
*Attorney for Petitioners.*

## APPENDIX

**Internal Revenue Code:**

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a * * * tax * * *.
(26 U. S. C. 1946 ed., Sec. 11.)

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
(26 U. S. C. 1946 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.
(26 U. S. C. 1946 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).
(26 U. S. C. 1946 ed., Sec. 182.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U. S. C. 1946 ed., Sec. 3797.)

**Treasury Regulations 111,** promulgated under the Internal Revenue Code:

SEC. 19.22 (a)-1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, * * *.

Statute:

Pa

Internal Revenue Code:

Sec. 11 (26 U.S.C. 1946 ed., Sec. 11) .....
Sec. 22 (26 U.S.C. 1946 ed., Sec. 22) .....
Sec. 181 (26 U.S.C. 1946 ed., Sec. 181) .....
Sec. 182 (26 U.S.C. 1946 ed., Sec. 182) .....
Sec. 3797 (26 U.S.C. 1946 ed., Sec. 3797) .....

Miscellaneous:

Treasury Regulations 111, Sec. 29.22(a)-1 .....

Page

12
12
12
13
13

14

# In the Supreme Court of the United States

OCTOBER TERM, 1950

---

No. 516

ELWIN S. BENTLEY, E. MERRITT ASHWORTH AND LEROY P. BROWNELL, PETITIONERS

*v.*

COMMISSIONER OF INTERNAL REVENUE

---

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT*

---

## BRIEF FOR THE RESPONDENT IN OPPOSITION

---

### OPINIONS BELOW

The opinion of the Tax Court (R. 192-205) is reported at 14 T.C. 228. The *per curiam* opinion of the Court of Appeals (R. 220) is reported at 184 F. 2d 668.

### JURISDICTION

The judgment of the Court of Appeals was entered October 31, 1950. (R. 221.) The petition for a writ of certiorari was filed January 25, 1951. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

# INDEX


| | Page |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 1 |
| Question presented | 2 |
| Statute and regulations involved | 2 |
| Statement | 2 |
| Argument | 7 |
| Conclusion | 11 |
| Appendix | 12 |


## CITATIONS

Cases:


| | |
|---|---|
| *Argo* v. *Commissioner*, 150 F. 2d 67, certiorari denied, 326 U. S. 762 | 10 |
| *Baumgartner* v. *United States*, 322 U. S. 665 | 11 |
| *Belcher* v. *Commissioner*, 162 F. 2d 974, certiorari denied, 332 U. S. 824 | 10 |
| *Commissioner* v. *Culbertson*, 337 U. S. 733 | 7, 10 |
| *Commissioner* v. *Sunnen*, 333 U. S. 591 | 7 |
| *Commissioner* v. *Tower*, 327 U. S. 280 | 7 |
| *Ginsburg* v. *Arnold*, decided December 21, 1950 | 9, 10 |
| *Goodyear Co.* v. *Ray-O-Vac Co.*, 321 U. S. 275 | 11 |
| *Harrison* v. *Schaffner*, 312 U. S. 579 | 7 |
| *Helvering* v. *Clifford*, 309 U. S. 331 | 7 |
| *Helvering* v. *Eubank*, 311 U. S. 122 | 7 |
| *Helvering* v. *Horst*, 311 U. S. 112 | 7 |
| *Henson* v. *Commissioner*, 174 F. 2d 846 | 9, 10 |
| *Lucas* v. *Earl*, 281 U. S. 111 | 7 |
| *Lusthaus* v. *Commissioner*, 327 U. S. 293 | 7 |
| *Mead* v. *Commissioner*, 131 F. 2d 323, certiorari denied, 318 U. S. 777 | 10 |
| *Morton* v. *Thomas*, 158 F. 2d 574, certiorari denied, 330 U. S. 834 | 10 |
| *Scherf* v. *Commissioner*, 161 F. 2d 495, certiorari denied, 332 U. S. 810 | 10 |
| *Sewell* v. *Commissioner*, 151 F. 2d 765, certiorari denied, 327 U. S. 783 | 10 |
| *Sewell's Estate* v. *Commissioner*, 151 F. 2d 806, certiorari denied, 327 U. S. 805 | 10 |
| *United States* v. *O'Donnell*, 303 U. S. 501 | 11 |
| *Virginian Ry.* v. *Federation*, 300 U. S. 515 | 11 |

### QUESTION PRESENTED

Whether the Court of Appeals erred in affirming the Tax Court's determination that taxpayers, not their wives, were the real owners and partners of a business controlled and operated by taxpayers as "employees" of their wives, and that therefore the portions of the business profits attributed to and reported by the wives were includible in taxpayers' gross incomes as defined in Section 22(a) of the Internal Revenue Code.

### STATUTE AND REGULATIONS INVOLVED

These appear in the Appendix, *infra*.

### STATEMENT

The facts as found by the Tax Court (R. 193-204) may be summarized as follows:

From 1939 until 1944 taxpayers Brownell, Ashworth and Bentley (hereafter sometimes called the husbands), and the wife of one of them (Mrs. Brownell), were the stockholders of Hoosick Engineering Company, Inc., which manufactured and sold automobile parts. Brownell and his wife together owned 362 shares of stock, Ashworth also owned 362 shares, and Bentley owned 105 shares. The business was managed by taxpayers, who possessed the technical skill and knowledge essential to its successful operation. The business sustained a slight loss during the first year of its operation but thereafter enjoyed increasing profits until 1943, when its net income amounted to $41,858.

(R. 193-195, 202.) For the 1945 and 1946 fiscal years the net income amounted to $51,008 and $78,328, respectively. (R. 195.)

In 1944 taxpayers decided to sell or liquidate the business because of their dissatisfaction with the amount of profits left after taxes. Their tax counsel suggested a plan whereby taxpayers' wives would form a partnership and employ taxpayers to operate the business. (R. 196, 202.) The plan was devised for the sole purpose of minimizing taxes. (R. 203.) Pursuant to the plan the corporation was dissolved, and a partnership of the same name, consisting of taxpayers' wives, was contemporaneously formed. (R. 196.) On the same day the three wives addressed an offer to the husband-stockholders, which the latter accepted, as follows (R. 196-197):

> 1. We will rent from you the use of your good name, and goodwill, and your leasehold rights (subject to the rents payable thereunder) for an annual rental beginning November 1, 1944 of Three Dollars ($3.00), being One Dollar ($1.00) per annum for each of the above named assets.
>
> 2. We will rent your equipment from you at an annual rate of six (6%) per cent of the cost thereof to you in the liquidation of the Hoosick Engineering Company, Inc., and we will agree in addition thereto, to maintain it in good condition, and to make at our expense all necessary, proper, and reasonable repairs and replacements to the end that we will deliver

back to you this plant in as good condition as received from you, less depreciation, which we shall describe as ordinary wear and tear. When we say "plant" we mean all of the equipment that you took over on the liquidation of the Hoosick Engineering Co., Inc.

3. We agree to pay the rent upon the property which you have under lease.

4. We will take over your accounts receivable, inventories and work-in-process at the price at which those assets came over to you from the Hoosick Engineering Co., Inc., in its liquidation and agree to pay you for the same.

5. We will take over all orders on the books, and all the business that the Hoosick Engineering Co., Inc., distributed to you, if any there be.

6. We agree to continue the Hoosick Engineering Co., Inc., Pension and Profit-Sharing Plan as our own.

In consideration of the foregoing we agree to pay you, in return for services rendered, annual salaries during the life of this agreement as follows: to Mr. LeRoy P. Brownell of $7500.00, to Mr. E. Merritt Ashworth $7500.00, and to Mr. Elwin S. Bentley $3500.00, and we promise to pay you as agreed in Paragraphs 1, 2 and 4 above.

The formation of the partnership composed of the wives was recorded with the state and county authorities. (R. 198.)

The arrangement produced no substantial change in the policies or operations of the business.

The wives knew nothing about the business or its operations, except what their husbands told them, and were completely lacking in the skills or abilities necessary to carry on the business. They had nothing to do with the management of the business other than to sign checks, and they signed whatever checks were presented to them without exception. The husbands had no power to sign checks but continued as before to control the business and to perform the identical duties they had theretofore performed as officers of the corporation. Their salaries from the partnership were approximately the same as those theretofore paid by the corporation, and generally in proportion to the former family stock interests in the corporation. For the second fiscal year of the partnership (ended August 31, 1946) their compensation was increased under a "management contract" so as to include a percentage of the profits, divisible in proportion to their salaries. Ashworth and Brownell each received $11,000 as "salary" plus $13,593 additional compensation under the "management contract", while Bentley received $3,550 as "salary" plus $3,965 additional compensation under the "management contract". (R. 197-199, 202-203.)

When the corporation was dissolved its balance sheet showed gross assets of $68,975, liabilities of $9,548, depreciation reserve of $17,162, and a net worth of $42,264. (R. 198.) The accounts receiv-

able and inventory which the wives agreed to "take over" from the husband-stockholders (R. 197) totalled $36,764; these receivables were collected and the inventory was liquidated within two years, and the proceeds paid over to the former stockholders. (R. 198.) The business had no borrowed funds and its capital requirements were small. (R. 199.) However, as part of the arrangement, Mrs. Brownell and Mrs. Ashworth each contributed $2,000 and Mrs. Bentley contributed $580. These amounts were fixed in accordance with the former family stockholdings in the corporation, and the business profits were made distributable to the wives in the same proportions. (R. 197-198, 202.)

For the first fiscal year of the partnership (9 months ending August 31, 1945) its net income amounted to $51,008, and for the second year to $78,328. All of this net income was distributed to and kept by the wives, and also reported by them for income tax purposes. (R. 198.) The husbands reported the salaries and the additional compensation received by them under the management contract. (R. 199.) The Commissioner determined that the amounts reported by the wives were includible in the gross incomes of their respective husbands. (R. 193.) The Tax Court held that the husbands earned the income which their wives reported and were the true owners and partners of the business. Accordingly, it sustained the Com-

missioner's determination. (R. 202-204.) The Court of Appeals affirmed *per curiam.* (R. 220.)

ARGUMENT

1. The decision below is in accord with the established principle that an anticipatory assignment of income, whatever its formal cloak, is ineffective taxwise. The principle applies whether the income in question is derived from services (*Lucas* v. *Earl,* 281 U.S. 111; *Helvering* v. *Eubank,* 311 U.S. 122), or from property (*Commissioner* v. *Sunnen,* 333 U.S. 591; *Harrison* v. *Schaffner,* 312 U.S. 579; *Helvering* v. *Horst,* 311 U.S. 112; *Helvering* v. *Clifford,* 309 U.S. 331), or from a blend of both sources (*Commissioner* v. *Tower,* 327 U.S. 280; *Lusthaus* v. *Commissioner,* 327 U.S. 293; *Commissioner* v. *Culbertson,* 337 U.S. 733). Where as here we are dealing with intra-family transactions, "special scrutiny of the arrangement is necessary" (*Helvering* v. *Clifford, supra,* p. 335), lest the tax incidence be shifted by "surface changes of ownership" (*Commissioner* v. *Culbertson, supra,* p. 746).

The Tax Court concluded (R. 202-204) that the instant arrangement, though couched in the form of a rental of the taxpayer-husbands' business assets to a partnership formed by their respective wives and the contemporaneous employment of the husbands by their wives to run the business, was in reality but an assignment to the wives of a portion of the future business profits earned by the hus-

bands; in short, that the husbands remained the true owners and partners of the business nominally carried on by the wives. The Tax Court's decision is abundantly supported by the record, and was correctly affirmed by the court below.

Pursuant to a plan proposed by their tax counsel, and for the sole purpose of reducing taxes, the husbands dissolved a corporation of which they were the stockholders and officers, and their wives contemporaneously purported to create a partnership to carry on the business. (R. 196, 202-203.) The husbands and wives then entered into an agreement, which had no fixed duration, whereby the wives purported to "rent" and "take over" the business assets from their husbands. (R. 196-197.) They also agreed to pay the husbands a salary plus a percentage of the profits under a "management contract", in proportion to the husbands' former stockholdings, the remaining profits to be divided among the wives in the same proportion. (R. 197-199, 202-203.) Although the wives contributed some capital of their own, its amount was small, a total of $4,580 in relation to a business having a net worth of about $42,000 (R. 198) and annual profits for the tax years in suit of over $50,000 (R. 195). Moreover, no new capital was needed. (R. 199.) The arrangement produced no substantial change in the policies or operations of the business. The husbands, who possessed the requisite skill and knowledge for carrying

on the business, continued as before to manage and control it. The wives knew nothing about the business. They furnished no services other than the formal signing of checks, and without exception they signed whatever checks were presented to them. The husbands never relinquished title to the business assets, nor control over their use, and the arrangement was terminable at will. Its only practical effect was to channel part of the business profits to the wives, and its sole objective was tax avoidance. (R. 199-200, 202-204.) To accord tax effect to the arrangement would exalt artifice above reality.[1]

2. The decision below does not, as taxpayers assert (Pet. 9-12), conflict with *Henson* v. *Commissioner,* 174 F. 2d 846 (C.A. 5th), or *Ginsburg* v. *Arnold* (C.A. 5th), decided December 21, 1950 (1951 C.C.H., par. 9108). In the *Henson* case, the court pointed out (p. 847) that the husband had "irrevocably divested himself of all legal title, right, interest, and control over the business." Here, on the other hand, the husbands retained both legal title to the business assets and full control over conduct of the business. (R. 202-203.) In the *Ginsburg* case, involving a claimed partner-

[1] The unreality of the arrangement is accentuated by the fact that within the first two years of the partnership the wives received (and reported) about $130,000 of profits in return for nothing more than their agreement to "rent" the plant and equipment and "take over" the accounts receivable and inventory, and for a small capital contribution ($4,580) which was not needed. (R. 196-198.)

ship between taxpayer and his children, the court noted that there was "no finding by the court below that they did not in good faith intend to join together as partners". Here, on the other hand, the Tax Court found (R. 203) that "the purpose of the wives' partnership was not the creation or operation of a joint enterprise", but solely "that of minimizing income taxes". The decisions of the Fifth Circuit Court of Appeals in the *Henson* and *Ginsburg* cases are to be compared with those of the same court in other family partnership cases, in which it affirmed the Tax Court's refusal to recognize the partnership for tax purposes, and in which this court denied certiorari.[2] There is no more occasion for further review of this case than of those cases.

Nor is the decision below in conflict with *Commissioner* v. *Culbertson,* 337 U. S. 733, as taxpayer alleges. (Pet. 9-11.) This Court there stressed (pp. 741-743) that whether a family partnership is entitled to tax recognition presents a question of fact in each case, depending upon the intention of the parties, no single factor being conclusive. Both courts below have found against

---

[2] See, *e.g.*, *Scherf* v. *Commissioner,* 161 F. 2d 495, certiorari denied, 332 U.S. 810; *Belcher* v. *Commissioner,* 162 F. 2d 974, certiorari denied, 332 U.S. 824; *Mead* v. *Commissioner,* 131 F. 2d 323, certiorari denied, 318 U.S. 777; *Argo* v. *Commissioner,* 150 F. 2d 67, certiorari denied, 326 U.S. 762; *Sewell's Estate* v. *Commissioner,* 151 F. 2d 806, certiorari denied, 327 U.S. 805; *Sewell* v. *Commissioner,* 151 F. 2d 765, certiorari denied, 327 U.S. 783; *Morton* v. *Thomas,* 158 F. 2d 574, certiorari denied, 330 U.S. 834.

the taxpayer on this factual issue. Since their concurrent findings are not clearly erroneous the case presents no occasion for issuance of the writ. *Cf. United States* v. *O'Donnell,* 303 U. S. 501; *Goodyear Co.* v. *Ray-O-Vac Co.,* 321 U. S. 275, 278; *Virginian Ry.* v. *Federation,* 300 U. S. 515, 542; *Baumgartner* v. *United States,* 322 U. S. 665.

## CONCLUSION

The decision below is correct. There is no conflict, and no occasion for further review. The petition for a writ of certiorari should be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
*Solicitor General.*
THERON LAMAR CAUDLE,
*Assistant Attorney General.*
ELLIS N. SLACK,
HARRY BAUM,
*Special Assistants to the Attorney General.*

FEBRUARY, 1951

APPENDIX

Internal Revenue Code:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a * * * tax * * *.

(26 U.S.C. 1946 ed., Sec. 11.)

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U.S.C. 1946 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

(26 U.S.C. 1946 ed., Sec. 182.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U.S.C. 1946 ed., Sec. 3797.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

> Sec. 29.22(a)-1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22(b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined. * * *.

* * * * *

☆ U. S. GOVERNMENT PRINTING OFFICE: 1981 930401 550

Office-Supreme Court
FILED
FEB 28 19
CHARLES ELMORE

No. 516.

IN THE

# Supreme Court of the United States

October Term, 1950.

---

ELWIN S. BENTLEY, E. MERRITT ASHWORTH AND LEROY P. BROWNELL, *Petitioners,*

v.

COMMISSIONER OF INTERNAL REVENUE.

---

## REPLY TO BRIEF OF RESPONDENT IN OPPOSITION.

---

HOWE P. COCHRAN,
510 American Building,
Washington 4, D. C.,
*Attorney for Petitioners.*

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

IN THE

# Supreme Court of the United States

October Term, 1950.

---

**No. 516.**

---

ELWIN S. BENTLEY, E. MERRITT ASHWORTH AND LEROY P. BROWNELL, *Petitioners,*

**v.**

COMMISSIONER OF INTERNAL REVENUE.

---

## REPLY TO BRIEF OF RESPONDENT IN OPPOSITION.

---

The brief of the respondent does not fairly state the case. The petitioners regret the necessity of calling the Court's attention to this fact.

On page 8, the respondent says:

> "* * * the husbands dissolved the corporation of which they were the stockholders and officers * * *."

This is a misstatement of a material fact.

The men owned a little over 87% of the corporation and one of the women owned a little over 12% of it.

It is respectfully suggested that there is no theory of law on which this woman can be ousted of her 12% ownership no matter what the correct rule in this case may be. She

always owned 12%. No one has a right to take it away from her. To conceal, in the argument, the fact that one of the women always owned 12% of the corporation is to mislead the Court.

Yet all through the respondent's brief, he pretends that the men owned the entire corporation.

---

On page 8, the respondent says that the net worth of the liquidated corporation was $42,000; and on page 9 he says:

> "* * * The husbands never relinquished title to the business assets * * *"

That is not true. The true facts are:

> (a) the men never had title to the business assets, for they owned only 87% of them; one of these women owned 12% of them; and
>
> (b) $36,764.08 of these $42,000 net assets were sold to these women on November 28, 1944, the day the corporation went out of business; title passed to them that day (Ex. 13; R. 92), and they paid for these assets in money over a period of fourteen months (R. 92).

It is no excuse for disguising this fact, to say that the women "took over" the assets and "collected them." That is a specious play upon words. It is submitted that "to take over and pay for" is to "buy." The books of account show a sale (Ex. 13). The women bought the assets, took title to them, and paid for them, just as is done in any business transaction.

---

Respondent, on page 3 of his brief, has omitted the fact that the corporation lost money in 1944, the year it liquidated.

Respondent insists the plan was one of tax avoidance, when it was not such a plan. The evidence clearly shows it was a business plan. The finding of the Tax Court that this was a tax avoidance plan is not supported by any evidence.

Respondent belittles the fact that the women were the record partners, put up the working capital from their own funds earned and saved by them, controlled the partnership finances, and drew and kept all the profits.

---

The statement of earnings by the corporation, and the later statement of earnings by the partnership (page 3 of respondent's brief) are not fairly compared, for the former are stated *after* salaries and the latter *before* salaries. The Tax Court made this same mistake.

---

Much is made of the fact that *after it had been decided to liquidate the corporation* counsel came forward with a plan to sell the business, which plan worked out successfully. There is no fault in salvaging a business, and nothing reprehensible in employing counsel capable of suggesting a plan that salvaged a dying business.

Respectfully submitted,

HOWE P. COCHRAN,
510 American Building,
Washington 4, D. C.,
*Attorney for Petitioners.*